Office-Supreme Court, U.S.
FILED
JUL 17 1981
ALEXANDER L. STEVAS,
CLERK

No. 80-1935

In the Supreme Court of the United States

October Term, 1980

A. SPENCER GILBERT III, Trustee in Bankruptcy
for Char-Mac Enterprises, Inc., et al.,
Petitioner,

vs.

FIRST NATIONAL BANK OF JACKSON, MISSISSIPPI,
Respondent.

BRIEF OF FIRST NATIONAL BANK OF JACKSON, RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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PARTIES

The Respondent is First National Bank of Jackson.

The parent corporation for the Respondent is First Capital Corporation, a Mississippi corporation.

F.S. Corporation, a Mississippi corporation, is a wholly owned subsidiary of First Capital Corporation, and therefore under Rule 28.1 may be considered an affiliated corporation of the Respondent.

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SUPPLEMENTAL STATEMENT OF THE CASE

The Trustee distorts the facts. The District Court found First National Bank of Jackson (FNB) acted in good faith in putting a stop to Duran's kite and in effecting the setoff. The trial court specifically found FNB acted without "actual intent" to defraud as required under § 67d. 463 F. Supp. at 172. The Court of Appeals affirmed.

According to the Trustee, FNB's only purpose in refusing to pay checks drawn on Duran's account was to "build up" the balance in the account so as to later set it

off against Duran's unrelated indebtedness to the bank. Yet the District Court found directly to the contrary and the Court of Appeals affirmed. According to the courts beneath, FNB's purpose in freezing Duran's account was an entirely honorable one, to fight Duran's kite. When FNB initially froze Duran's account, its motivation was to save the bank from a loss on the kite, not to collect an unrelated debt from Duran. Because of the "midnight deadline" rule (Miss. Code Ann. § 75-4-302 (1972)), FNB was seriously exposed. If Citizens National Bank (CNB) had discovered the kite before FNB, it could have returned Duran's checks drawn on his CNB account to FNB. In such event, it would have been FNB, not CNB, which would have been left with a large loss on the kite.

Finally, the Trustee mentions FNB's return of collateral to Duran after the setoff, but fails to tell the Court the value of that collateral or what was done with it after FNB released it. At trial, witnesses for FNB testified the collateral had a value of at least $500,000. The Trustee produced no evidence to the contrary. After FNB liquidated Duran's $500,000 indebtedness by means of the setoff, this $500,000 in collateral was immediately pledged against Duran's loans with CNB. Since FNB released collateral worth at least as much as the indebtedness it liquidated, it is small wonder the Fifth Circuit could find no "transfer" or "depletion of the bankrupt's estate" as a result of the setoff attacked by the Trustee.

ARGUMENT

The Trustee asserts the Petition for Certiorari should be granted (1) because the decision beneath is "contrary to the decisions of this Court" and (2) because the case presents an "issue of first impression." Passing over the obvious contradiction inherent in so framing the issues,* the Trustee is wrong on both counts. The decisions of this Court are neither contrary to the decision beneath of the Court of Appeals for the Fifth Circuit nor do they support the Trustee's position, which has, in fact, been rejected by at least one appellate court.

The Trustee says § 67d condemns as fraudulent, as a matter of law, any setoff made within one year of the filing of the bankruptcy petition if, prior to the setoff, the bank permitted the balance in the depositor's account to rise or "build up." In the first place, such a contention is in the face of the language of § 67d itself which requires a finding, not of legal or presumed fraud, but of fraud in fact. The second difficulty with the Trustee's theory is that there is absolutely no case law to support it. The Trustee's proposed requirement that the deposits into the bank account be made in "the regular course of business" is a requirement under § 60 of the Act (transfers within four months of filing), but there is not one decision imposing such a requirement in the context of § 67d. As noted in the opinion beneath of the Court of Appeals, every case cited in the Trustee's petition is a § 60 case. In each decision in which the "regular course of business" requirement was imposed, the setoff occurred within four months of the filing. In the instant case, the setoff occurred more than

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*How can a case be one for which there is no controlling precedent and also one which has been decided contrary to existing precedent?

four months prior to filing and is, therefore, outside the ambit of § 60. The "regular course of business" test has no application.

The existing law, the law which the Trustee asks this Court to change, is that setoffs are permitted both within the one year period of § 67d and within the four month period of § 60, but a setoff made within four months of filing is a voidable preference under § 60 to the extent the deposits made to the accounts were not in the regular course of business. That is, if at the time the bank received the deposits, it had already made a conscious decision to apply them to an unrelated debt of the depositor, and if the setoff is then effected within four months of the filing of the petition, then the setoff is violative of the bankruptcy laws. *In re Applied Logic Corp.*, 576 F.2d 952, 962 (2nd Cir. 1978). Contrary to the Trustee's position, there is no requirement that deposits in a § 67d case be made in the regular course of business. This is true because transactions within one year of filing are too remote in point of time to be considered questionable and therefore not entitled to the presumption of fraud or overreaching applicable to a § 60 transfer.

The trustee in *Applied Logic, supra,* made a similar attack on a setoff, contending that the transaction in question should be set aside because the deposits were not made in the ordinary course of business. The Second Circuit rebuffed the trustee, holding the "regular course of business" requirement has no field of operation outside § 60.

> The trustee argues alternatively that [the bank] had no right of setoff because the deposits were not made in the regular course of business and were not withdrawable at the will of the depositor. This raises the question whether this often used language is a judicial gloss imposed on Section 68a regardless of the

time when the deposits were made or simply an affirmation that Section 68a cannot be used to validate what would otherwise be a preference voidable under §§ 60a and b.

The latter conclusion is dictated both by reason and authority as recent as this court's decision in *Katz v. First National Bank of Glen Head*, 568 F.2d 964 (2d Cir. 1977).... 576 F.2d at 961-62.

The *Applied Logic* opinion goes on to state that deposits failing to comply with the "regular course of business" requirement which were made within four months of bankruptcy could *not* be setoff; however, those deposits made, even though not in the regular course of business, more than four months from the date of bankruptcy were unobjectionable under the Bankruptcy Act. 576 F.2d at 962-63. The holding beneath brings the Fifth Circuit into agreement with the Second. The "regular course of business" rule applies *only* when the question is whether a preference may be avoided under § 60. The regular or ordinary course of business principle has no place in a § 67d case.

Even if this Court were disposed to embrace the Trustee's position on "regular course of business," this is not the proper case in which to do so because the result would remain the same. The trial court found the Trustee's contentions of bad faith without support in the record. Implicit in that finding is a rejection of Trustee's contention that FNB decided to "build up" the balance in Duran's account in order to set it off against his debt. Instead, the District Court accepted FNB's argument that its purpose in freezing Duran's account was to stop the kite. The affirmance by the Court of Appeals was based in part on this finding. Rather than create some new principle as the Trustee claims, all the Fifth Circuit did in its decision

beneath was to conclude that since the deposits *were* made in the regular course of business, the trial judge's conclusion that there had been no fraud in fact on the part of FNB was supported by the evidence. To establish a new principle requiring a regular course of business finding in a § 67d case, as well as in a § 60 case, would not affect the outcome in this case since there is already a finding (unchallenged here) that the deposits in question *were* made in the regular course of business.

The fallacy in the reasoning of the Trustee is apparent in his characterization of the Fifth Circuit's ruling as one to the effect that a setoff by a bank is not a "transfer" under § 67d. What the appellate court beneath actually said was that a deposit to a checking account by one who, more than four months thereafter, files for bankruptcy is not a transfer under § 67d. This is so because it does not deplete the bankrupt's estate. It is simply a change in the nature of an asset. *New York County National Bank v. Massey*, 192 U.S. 138, 145-47 (1904); *Citizens National Bank v. Linberger*, 45 F.2d 522, 526 (4th Cir. 1930) ("A deposit in a bank is not a sale or parting with property, or its possession, as a payment, pledge, mortgage, gift or security. It does not deplete the estate of the depositor. . . .")

Finally, the Trustee is asking the Court to devote its limited judicial resources to the creation of a legal principle which will have no precedential value in future cases. The case at bar was filed under, and is controlled by, the old Bankruptcy Act.

CONCLUSION

Even if one accepts all the contentions of the Trustee, FNB will prevail on the merits. All the bank did was (1) attempt to protect itself from Duran's massive and fraudulent check writing scheme and (2) attempt to protect itself from a loss on Duran's indebtedness. As both courts beneath have found, there was no fraud in fact on the part of the bank. A contrary finding is absolutely necessary if the Trustee is to prevail under § 67d. The Trustee cannot prevail where FNB merely employed legitimate means to protect its own proper interests.

Respectfully submitted,

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July 15, 1981